

Message Text

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INFO AMEMBASSY BRUSSELS
AMEMBASSY LUXEMBOURG

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E.O. 11652: N/A
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SUBJECT: ECONOMIC AND DEVELOPMENT REVIEW COMMITTEE
(EDRC) REVIEW OF BELGIUM AND LUXEMBOURG (BLEU)

REF: (A) EDR(77)12; (B) STATE 107940;
(C) BRUSSELS 4797; (D) OECD PARIS 13667

1. SUMMARY: AT MAY 13 EDRC REVIEW, BELGIAN DEL (LED BY
SWEVERS, MINISTRY OF ECONOMIC AFFAIRS) PRESENTED UPDATED
FIGURES CONTAINING DOWNWARD REVISION OF GNP GROWTH AND
INFLATION FORECASTS FOR 1977, BUT NEVERTHELESS STRONGLY
RESISTED SECRETARIAT'S RECOMMENDATION THAT GOB ADOPT
SOMEWHAT MORE EXPANSIONARY FISCAL POLICY THAN PRESENTLY
PLANNED. AFTER LENGTHY DEBATE ON STIMULATION QUESTION,
BELGIANS AND SECRETARIAT AGREED THAT ADDITIONAL STIMULUS
MIGHT BE APPROPRIATE, BUT THAT SPECIFIC MEASURES TO THIS
END SHOULD BE CONSIDERED IN LIGHT OF NEED TO REDUCE BUD-
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GET DEFICIT OVER MEDIUM TERM. BELGIANS FORECAST CURRENT
ACCOUNT EQUILIBRIUM FOR BLEU IN 1977, BUT STRESSED THAT
STRUCTURAL ADAPTATION WILL BE NECESSARY IN CERTAIN SEC-
TORS (E.G., STEEL, TEXTILES) TO MAINTAIN HEALTHY EXTERNAL
POSITION OVER MEDIUM TERM. LUXEMBOURG DEL (LED BY KIRSCH,
FINANCE MINISTRY) AGREED WITH SECRETARIAT'S VIEW THAT
DEPRESSED CONDITIONS IN STEEL MARKET WOULD PRECLUDE SIG-

NIFICANT PICKUP IN ECONOMIC ACTIVITY THIS YEAR.
END SUMMARY

2. BELGIAN SHORT-TERM PROSPECTS, DOMESTIC OUTLOOK FOR 1977: LATEST OFFICIAL FORECASTS FOR 1977 CIRCULATED BY BELGIANS AT EDRC REVIEW REVISE DOWNWARD THOSE PREPARED AT BEGINNING OF YEAR. ADJUSTMENT STEMS LARGELY FROM INCREASED PESSIMISM CONCERNING EVOLUTION OF PRIVATE CONSUMPTION SPENDING DURING BALANCE OF THIS YEAR. WHEREAS GOB HAD PREVIOUSLY PROJECTED DECLINE IN HOUSEHOLD SAVINGS RATIO AND 4.5 PERCENT INCREASE IN CONSUMPTION, CURRENT EXPECTATION IS THAT SAVINGS RATIO WILL REMAIN AT 1975 LEVEL AND THAT CONSUMPTION WILL ONLY RISE BY 3.1 PERCENT. GOB HAS RAISED ITS ESTIMATES OF GROWTH OF PUBLIC INVESTMENT, OF PRODUCTIVE INVESTMENT, AND OF RESIDENTIAL CONSTRUCTION IN 1977. HOWEVER, THESE MOVEMENTS PROVIDE ONLY A PARTIAL OFFSET TO REDUCTION OF PROJECTED GROWTH IN PRIVATE CONSUMPTION.

3. NOTING THAT PRODUCTIVE INVESTMENT HAD DECLINED IN 1976, EDRC AND SECRETARIAT POINTED WITH CONCERN AT CONTINUED WEAKNESS IN THIS AREA IMPLIED BY 2.1 PERCENT INCREASE IN 1977 FORECAST BY GOB. EDRC DELS OFFERED SEVERAL EXPLANATIONS FOR THE SITUATION, INCLUDING: (A) RATHER ABRUPT SWINGS IN ECONOMIC POLICY; (B) RUMORS OF NEW TAX ON CAPITAL; (C) HIGH INTEREST RATES RESULTING FROM RESTRICTIVE MONETARY POLICY NECESSARY TO DEFEND FRANC; AND (D) FAILURE TO MOVE IN HARMONY WITH OTHER EC COUNTRIES TO FULL REBATE OF VAT ON INVESTMENT. BELGIANS LIMITED OFFICIAL USE

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DOUBTED WHETHER THESE FACTORS HAD IMPORTANT DEPRESSANT EFFECT ON INVESTMENT. IN RESPONSE TO U.S. QUESTION, BELGIANS INDICATED THAT MONETARY SQUEEZE IN 1976 HAD PUSHED UP SHORT-TERM RATES, BUT THAT SEGMENTATION OF FINANCIAL MARKETS (DUE IN PART TO OFFICIAL CONTROLS) HAD INSULATED LONG-TERM RATES FROM SIMILAR UPWARD PRESSURE. THEY ACKNOWLEDGED, HOWEVER, THAT IMPLEMENTATION OF FULL REBATE ON VAT ON INVESTMENT COULD HAVE STIMULATORY EFFECT ON INVESTMENT AND EXPRESSED INTENTION (AS THEY HAD AT 1976 EDRC REVIEW) OF MOVING IN THIS DIRECTION. (THEY ESTIMATE THAT FULL REBATE WOULD REDUCE TAX REVENUES BY 9 BILLION BELGIAN FRANCS.) BELGIANS FELT THAT SEVERAL PROVISIONS OF EGMONT PLAN WOULD GIVE BOOST TO INVESTMENT AND WHILE SOME OF THESE COULD NOT BE IMPLEMENTED UNTIL FORMATION OF NEW GOVERNMENT, POSITIVE "ANNOUNCEMENT EFFECT" ON INVESTMENT LIKELY TO OCCUR.

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4. INFLATION OUTLOOK: BELGIANS NOTED THAT ONE OF THE FEW FAVORABLE IMPLICATIONS OF SLOWER THAN EXPECTED GROWTH OF DEMAND IN 1977 WOULD BE MORE MODERATE INFLATION RATE. GOB FORECASTS 7.2 PERCENT RISE IN GNP DEFLATOR IN 1977, COMPARED WITH PREVIOUSLY FORECAST INCREASE OF 8.1 PERCENT. BELGIANS EXPECT INCREASE IN UNIT LABOR COSTS TO DECELERATE FROM 11.6 PERCENT TO 7.5 PERCENT BETWEEN 1976 AND 1977. THEY ADDED THAT (A) PRICE IMPACT OF APRIL 1 INCREASE IN VAT WOULD BE LESS THAN MECHANICAL CALCULATIONS WOULD INDICATE DUE TO WEAK DEMAND SITUATION AND (B) APPRECIATION OF FRANC HAD DULLED DOMESTIC PRICE IMPACT OF COMMODITY PRICE INCREASES.

5. UNEMPLOYMENT: INFLATION PROSPECTS CONSTITUTED SILVER LINING OF UNEMPLOYMENT CLOUD. GOB ESTIMATES THAT TOTAL UNEMPLOYMENT REACHED 215,000 IN 1976 AND FORESEES RISE TO 243,000 IN 1977. EMPLOYMENT EFFECT OF RECOVERY OF
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PRODUCTION HAS BEEN REFLECTED PRIMARILY IN INCREASE IN HOURS WORKED RATHER THAN IN FALL IN UNEMPLOYMENT. (BELGIANS PUT NUMBER OF WORKERS ON SHORT TIME AT 83,000 IN 1975, 58,000 IN 1976 AND SEE FURTHER DECLINE TO 38,000 IN 1977.)

6. LUXEMBOURG GENERALLY AGREED WITH SECRETARIAT VIEW THAT ADVERSE OUTLOOK FOR STEEL MARKET WOULD PRECLUDE SIGNIFICANT PICKUP IN ECONOMIC ACTIVITY IN 1977. STRONG GROWTH IN PRIVATE INVESTMENT SPENDING FORECAST FOR THIS YEAR REFLECTS MAJOR EFFORT NOW UNDERWAY TO RESTRUCTURE AILING STEEL INDUSTRY.

7. BLEU CURRENT ACCOUNT: BELGIANS FORECAST 5.2 PERCENT GROWTH OF BLEU EXPORT MARKETS IN 1977, EQUIVALENT RISE OF EXPORT VOLUMES AND 4.7 PERCENT INCREASE IN VOLUME OF IMPORTS. CURRENT ACCOUNT SURPLUS PROJECTED FOR FIRST HALF OF 1977 EXPECTED TO BE OFFSET BY DEFICIT IN SECOND HALF WITH RESULT THAT, FOR YEAR AS WHOLE, CURRENT ACCOUNT SHOULD BE IN BALANCE. BELGIANS REJECTED SECRETARIAT CONTENTION THAT LOSS IN EXPORT MARKET SHARES EXPERIENCED IN 1976 WAS TRACEABLE TO DETERIORATION IN THEIR INTERNATIONAL COMPETITIVE POSITION. THEY PRESENTED IMPRESSIVE ARRAY OF DATA SHOWING THAT, BY SEVERAL MEASURES OF COMPETITIVENESS (RELATIVE EXPORT UNIT VALUE; RELATIVE UNIT LABOR COSTS; CONSUMER AND WHOLESALE PRICES), BELGIAN COMPETITIVE POSITION HAD IMPROVED VIS-A-VIS OTHER EUROPEAN COUNTRIES (ALBEIT WORSENING CONSIDERABLY VIS-A-VIS U.S.) BETWEEN 1971 AND 1976. BELGIANS STATED THAT CURRENT ACCOUNT DOES NOT CONSTITUTE CONSTRAINT TO GROWTH IN SHORT RUN, BUT THAT MAJOR STRUCTURAL ADJUSTMENT IN CERTAIN SECTORS (E.G., STEEL, TEXTILES) IS NEEDED TO MAINTAIN HEALTH OF EXTERNAL SECTOR IN MEDIUM TERM.

8. FISCAL AND MONETARY POLICY: EDRC DISCUSSION REVOLVED AROUND SECRETARIAT RECOMMENDATION THAT MORE STIMULATORY LIMITED OFFICIAL USE

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FISCAL POLICY THAN CURRENTLY PLANNED BY GOB FOR 1977 WOULD BE APPROPRIATE, FOR BOTH INTERNATIONAL AND DOMESTIC REASONS. BELGIANS STRONGLY RESISTED SECRETARIAT RECOMMENDATION ARGUING THAT (A) BUDGET DEFICIT ALREADY TOO LARGE AND MUST BE REDUCED OVER MEDIUM TERM; MOREOVER, DEFICIT LARGELY STRUCTURAL AND WOULD NOT BE SIGNIFICANTLY

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REDUCED BY FASTER GROWTH; (B) SECRETARIAT RECOMMENDATION FOR INCREASE IN EMPLOYMENT IN PUBLIC SECTOR CONTRARY TO GOB MEDIUM-TERM GOAL TO CONTAIN GROWTH OF PUBLIC CONSUMPTION; (C) "TEMPORARY" INCREASES IN SPENDING BECOME PERMANENT, THEREBY CONTRIBUTING TO STRUCTURAL COMPONENT OF DEFICIT; (D) ALTHOUGH INFLATION RATE STANDS AT OR BELOW OECD AVERAGE, RELEVANT COMPARISON FOR "SNAKE COUNTRY" IS FRG WHOSE INFLATION RATE IS IN REGION OF 4 PERCENT; AND (E) UPWARD RATCHETING OF SIZE OF PUBLIC SECTOR WOULD RESULT IN DEGRADATION OF BELGIAN ECONOMY. AFTER LENGTHY DEBATE ON THIS ISSUE (DURING WHICH MOST EDRC DELS REMAINED NEUTRAL OR SILENT), SECRETARIAT AND BELGIANS AGREED THAT WEAK DEMAND/EMPLOYMENT PROSPECTS CALLED FOR MODERATE INFUSION OF STIMULUS, BUT THAT MEASURES ADOPTED TO THIS END SHOULD BE CONSISTENT WITH GOB'S MEDIUM-TERM GOAL OF REDUCING BUDGET DEFICIT AND OF LIMITING GROWTH OF PUBLIC SECTOR.

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9. RE POINT RAISED PARA 4, REF B, SECRETARIAT ESTIMATE OF CONSUMER PRICE INCREASE IN 1976 (9.2 PERCENT) IS BASED ON CONSUMER PRICE INDEX AS REVISED BY GOB IN JUNE,

1976. RISE OF 7.6 PERCENT BETWEEN DECEMBER, 1975 AND DECEMBER, 1976 CONSISTENT WITH 9.2 PERCENT AVERAGE INCREASE FOR YEAR. QUESTIONS POSED REF B, PARAS 3, 5, 8 AND 9 COVERED PARAS 2, 7, 8 AND 3. QUESTIONS RAISED REF C, PARAS 6A, 6B AND 6C ADDRESSED PARAS 8, 3 AND 7. KATZ

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